

ABC, Inc.

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Sam Antar
Vice President
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August 3, 1998

100-23-6298

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Hand Deliver

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, DC 20554

Dear Ms. Salas:

On behalf of ABC, Inc., transmitted herewith for filing with the Commission are an original and four copies of its Reply Comments in MM Docket No. 97-247.

If there are any questions in connection with the foregoing, please contact the undersigned.

Very truly yours,

A handwritten signature in dark ink, appearing to read "S. Antar", followed by a horizontal line.

Sam Antar

SA/ak
Enclosures

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION

In the Matter of)
)
Fees for Ancillary or Supplementary) MM Docket No. 97-247
Use of Digital Television Spectrum)
Pursuant to Section 336(e)(1))
of the Telecommunications Act of 1996)

Reply Comments of ABC, Inc.

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To: The Commission

Reply Comments of ABC, Inc.

In these Reply Comments, we will respond primarily to the comments filed in this proceeding by the National Cable Television Association (“NCTA”) and by The Office of Communication of the United Church of Christ, the Benton Foundation, the Center for Media Education, the Civil Rights Forum and the Media Access Project (“UCC, et al”)

I. The Commission was Correct Both as a Matter of Statutory Implementation and as a Matter of Policy in Deciding that the Fee Program Should Not Discourage the Provision of Ancillary and Supplementary Services By Broadcasters

UCC et al argue that the Commission was incorrect in deciding that in implementing its statutory mandate it should provide an incentive to broadcasters to offer ancillary services. We disagree. Section 336 of the Telecommunications Act of 1996 (“1996 Act”), which is entitled “Broadcast Spectrum Flexibility”, authorizes the Commission to adopt such regulations as the Commission determines are in the public interest to permit broadcasters to use the spectrum for ancillary services. In implementing this mandate, the Commission determined that one goal of the

fee program should be that fees not be set so high as to dissuade broadcasters from offering ancillary services. Setting this goal is both consistent with the “spectrum flexibility” language of the statute and with the legislative history. Too high a fee would afford broadcasters very little “spectrum flexibility”. The House Report on the Telecommunications Act emphasized the connection between permitting broadcasters flexibility in use of the spectrum for ancillary services and the desired “public policy goal of providing additional services to the public” and encouraging “innovation.”¹ Moreover, in taking into account the benefits consumers receive from new services, the Commission was well within the discretion given to it by the statute to determine what regulations are in the public interest.

The Commission’s approach also finds support in the general objectives of the 1996 Act. In establishing the service rules for DTV broadcasting, the Commission noted that the 1996 Act seeks “to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies.”² In Appendix A to our opening round comments in this proceeding, Dr. Jerry Hausman points out that, as the 1996 Act recognizes, consumers benefit greatly from the introduction of successful new telecommunications services and that rates set too high would discourage entry and thereby frustrate one of the goals of the 1996 Act.³

¹H Rep No. 204, 104th Cong., 1st Sess., 116 (1995). The 1996 Act’s provisions with respect to fees for ancillary services were based on the House Bill. H. Rep. No. 458, 104th Cong., 2nd Sess., 161.

²Fifth Report and Order in MM Docket 87-268 (“Fifth Report and Order”) quoting Preamble to Public L.No. 104-104, 110 Stat 56 (1996)

³Comments of ABC, Inc., Statement of Dr. Jerry A. Hausman (“Hausman”), at Paragraph 15.

We believe that the Commission's approach is also correct as a matter of sound public policy. Dr. Hausman observes that successful new services lead to "hundreds of millions or billions of dollars of increased consumer welfare."⁴ In deciding to encourage ancillary services, the Commission is duly recognizing that lower fees, which afford more favorable entry conditions for ancillary services, is a better policy choice than somewhat higher government revenues resulting in fewer new services. In Dr. Hausman's words, "the relevant tradeoff is marginal increases in revenues from slightly higher rates versus the attempted introduction of a new ancillary service, which, if successful, will create a significant increase in consumer welfare. Given this tradeoff and the high degree of uncertainty about the future success of ancillary services, the Commission should initially set low rates."⁵

II. An Initial Fee Set at a Low Percentage Rate Would Not Unfairly Subsidize Broadcasters to the Detriment of the Public or Give Broadcasters an Unfair Competitive Advantage Over Non-Broadcast Providers of Ancillary Services

In our initial comments, we proposed that the Commission set the initial fee at a low percentage rate under either a gross revenue or net revenue formula. NCTA argues to the contrary -- that unless the Commission requires broadcasters to pay a fee that represents "a significant portion of their gross revenues"⁶ the public will be harmed because broadcasters will offer less HDTV or fewer channels of free television.⁷

⁴Id

⁵Hausman, at Paragraph 17.

⁶NCTA Comments, at page 11.

⁷Id, at page 3.

The concern expressed by NCTA has already been addressed and resolved by the 1996 Act and by the DTV services rules established by the Commission. The 1996 Act expressly contemplates that broadcasters would be permitted to offer both free over-the-air and supplemental ancillary services and instructs the Commission to allow broadcasters to offer ancillary services subject to regulations the Commission is authorized to adopt. Subject to specified limitations set forth in the Act,⁸ the Commission is given the discretion to craft such regulations with respect to the use of spectrum for ancillary purposes “as may be consistent with the public interest, convenience and necessity.”⁹ In exercising that discretion, the Commission was faithful to the balance struck in the Act between the need to preserve the public good of free television and the desirability of fostering the growth of innovative services and thus determined that broadcasters should have wide latitude to offer ancillary services. Subject only to the requirement that “broadcasters must provide a free digital video programming service the resolution of which is comparable to or better than that of today’s service and aired during the same time periods that their analog channel is broadcasting,” broadcasters are permitted to offer virtually any new subscription service that does not interfere with the one required free service.¹⁰

In adhering to this statutory balance, the Commission found that it would enhance rather than detract from free television by providing the opportunity to develop additional revenue streams which “will help broadcast television to remain a strong presence in the video programming market

⁸47 USC 336 b)

⁹47 USC 336(a)(2)

¹⁰Fifth Report and Order at paragraph 29.

that will, in turn, help support a free programming service.”¹¹ The Commission also found that permitting broadcasters to assemble commercially attractive packages of services -- free and subscription -- would promote swift DTV penetration and acceptance which will likewise “help promote the success of the free television service.”¹²

NCTA’s argument seems to be based on a faulty premise that, unless nipped(?) at the outset, ancillary services will supplant free services. First, the argument wholly ignores the FCC service rules which already mandate the provision of free services. Second, wholly apart from those rules, the argument turns economics on its head. Ancillary services will be start-up, highly risky businesses untested in the marketplace. Entry is uncertain and a fee set too high will discourage entry altogether. In setting a fee at a level that would stimulate experimentation and innovation, the Commission would be relying on the marketplace to determine the appropriate mix of free and subscription services. In the event that, based on real world marketplace experience, the Commission decides that some other balance should be struck, the Commission has the statutory authority to adjust the fee program in the future.¹³

NCTA also argues that a fee set at a level that would stimulate entry would afford broadcasters an unfair competitive advantage over non-broadcast providers of ancillary services.¹⁴ In support of its argument, NCTA points out that cable operators pay franchise fees of up to 5% and that they also incur “fair market costs” for the facilities needed to upgrade their plants to offer new

¹¹Id.

¹²Id, at Paragraph 33.

¹³47 USC 336 (e) (2) (C).

¹⁴NCTA, at page 3.

ancillary services.¹⁵ In contrast, NCTA says, broadcasters pay nothing for their distribution plants because they “have the luxury of free use of spectrum.”¹⁶ The NCTA argument is specious. First, despite their use of spectrum, broadcasters are no different from cable in incurring “fair market costs” to build their digital facilities. Second, cable operators already enjoy a major competitive advantage over broadcasters because they occupy the overwhelmingly dominant position in the multichannel video marketplace. The fact that cable operators pay franchise fees to secure their favored position is no reason why broadcasters should pay comparable fees for the mere opportunity to offer ancillary services. Finally, it is sophistry to suggest that a high ancillary use fee should be assessed because broadcasters are somehow gaining spectrum for free. In point of fact, broadcasters will be financing a transition of the country’s terrestrial broadcast system from analog to digital at the end of which they will wind up with no more spectrum than they have today. This transition expense of about 8 to 10 million dollars per station will be incurred well in advance of any audience capable of receiving the digital signal. Given this expense (without the prospect of any significant immediate reward) and the fact that broadcasters will wind up at the end of the day with the same amount of spectrum as they now have, the 6 MHz being loaned to make the transition possible cannot fairly be described as being given to broadcasters for free, let alone serve as a basis for imposing a punitive levy on ancillary services.

¹⁵Id, at page 5.

¹⁶Id, at page 9.

III. Mineral Lease Fees, Concessionaire Fees, and Cellular Licence Auction Prices Are Not an Appropriate Benchmark For Assessing Fees For Spectrum Used For Ancillary Services

UCC et al and NCTA both cite the fees paid by mining and oil companies for the right to drill for gas and oil on federal public lands, ranging from 12.5% to almost 17% of gross revenues, as an appropriate model for valuing spectrum used for ancillary services.¹⁷ Both commentators ignore the key distinction between minerals and spectrum. Minerals are a depletable resource which, once use, have no value, while spectrum is not depletable. For this reason, we agree with commentator Thomas C. Smith that “spectrum should be valued different than other government resources”.¹⁸

UCC et al also cites the fees paid certain federal agencies for the right to operate concessions on public lands.¹⁹ Yet UCC et al offers no reason why the right to operate a restaurant or a store on federal property has any relevance to the value of spectrum for new telecommunications services. It can hardly be claimed that there is any public policy reason for incentivizing concessionaires to introduce new and risky services. Yet, that is at exactly what is at stake in the case of ancillary services. As Dr. Hausman has pointed out, successful new services can lead to hundreds of millions or billions of dollars of increased consumer welfare.²⁰

NCTA argues that the value of spectrum for ancillary services is substantial based on prices it cites that were paid at auction for PCS licenses in New York and Los Angeles.²¹ If these isolated

¹⁷UCC et al, at page 9; NCT, at page 9.

¹⁸Comments of Thomas C. Smith, at Page 4.

¹⁹UCC et al, at page 9.

²⁰Hausman, at paragraph 15.

²¹NCTA, at pages 12-13.

examples are put into the context of Dr. Hausman's comprehensive econometric study of all auctions that the FCC has conducted, it becomes clear that the examples prove nothing. As we pointed out in our earlier comments, Dr. Hausman's study demonstrates that:

1. There is a marked downward trend in winning bids for PCS licenses;
2. PCS spectrum significantly overstates the value of spectrum for ancillary services;
3. Prices paid for WCS and LMDS spectrum, which are a better predictor of ancillary spectrum auction values because of the greater technological and business uncertainty associated with those services, are dramatically lower than prices for PCS spectrum: and
4. The increasing supply of spectrum will drive down future auction prices.

IV. Retransmission Consent Compensation is Not Feeable Under the 1996 Act

UCC et al argues that compensation that broadcasters negotiate with cable operators for the right to carry their signals is feeable under the 1996 Act. In support of its position, UCC et al cites 336 (e)(1)(B) of the Act which imposes fees on payments by third parties to broadcasters (other than fees for commercial advertisements) for transmitting the ancillary services of those third parties on broadcasters' DTV channels. The UCC et al argument flies in the face of the plain language and common sense meaning of the statute and is unsustainable.

There are only two categories of ancillary services to which fees apply - services transmitted in return for third party payments, cited by UCC et al and covered by 336(e)(1)(B), and services for which a subscription fee is required, which is covered by 336(e)(1)(A). Retransmission consent fees do not fit either category.

First, retransmission consent compensation does not fit 336(e)(1)(B) because it is not paid "in return for transmitting material furnished by the third party." A retransmission consent

transaction is just the opposite. The cable operator pays for the right to transmit the broadcaster's material, not to have the broadcaster transmit materials furnished by the cable operator.

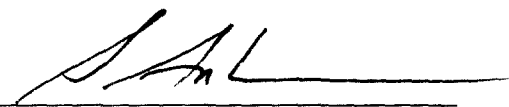
Second, retransmission consent is most certainly not a subscription fee paid to receive the ancillary service within the meaning of the Act.. Although not specifically defined in the 1996 Act, a subscription fee can only sensibly be understood to mean a fee charged by the broadcaster to the viewer, or the recipient of the service. The retransmission consent transaction is manifestly not of this character. Indeed, there is absolutely nothing in the Act or its legislative history to so much as suggest that Congress intended to levy a fee on retransmission consent compensation, a well established form of transaction that significantly predated the 1996 Act and has nothing whatsoever to do with the ancillary services to which this particular section of the Act was addressed.

Indeed the UCC et al argument ignores the fact the fee imposed by the statute is a fee on the broadcaster's use of spectrum to provide services directly to consumers that are supplemental to the free over the air programming service. The fee collection section of the statute, 336(e)(2)(A) requires that the Commission recover "a portion of the value of the public spectrum resource made available" for ancillary services. In describing ancillary services that are feeable, the statute makes reference to the use of spectrum in three other places -- "on designated frequencies" in 336(a)(2), "use of a designated frequency" in 336(b)(1), and "on a designated frequency" in 336(e)(1). In the case of retransmission consent, the payment is for the right to carry the broadcaster's free over the air signal; it has nothing to do with the use of spectrum to provide ancillary services to consumers.

The fact that the cable operator may pick up the broadcaster signal off the air is no relevance to this analysis. A contrary interpretation would lead to the anomalous result that retransmission consent payments would be feeable if the cable operator picks up the signal off the air but would

not be feeable if the broadcaster provides a direct feed to the cable operator as many broadcasters do. Treating retransmission consent payments as feeable would lead to another odd and inconsistent result - free television services would be non-feeable as transmitted over the air but feeable on cable systems. These anomalies arise because UCC is trying to distort what is in effect a rights payment (for the right to retransmit the broadcaster's free over-the-air signal) into a subscription fee for a service ancillary to those rights. Surely this is not what Congress intended. Indeed, since retransmission consent is a creature of Congress, enacted as part of the Cable Act of 1992, one can only conclude that if Congress had intended to condition the exercise of retransmission consent it would have done so explicitly. It did not do so in the 1996 Act and no such meaning should be read into the statute.

Respectfully submitted,

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